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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

October 29, 1997

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

Re: Ex Parte Presentation:

In the Matters of American Communications Services, Inc.'s Petition for
Declaratory Ruling Regarding Preemption of the Arkansas Telecommunications
Regulatory Reform Act of 1997 and MCI Telecommunications Corporations'
Petition for Expedited Declaratory Ruling Regarding Preemption of the Arkansas
Telecommunications Regulatory Reform Act of 1997, CC Docket No. 97-100

Dear Mr. Caton:

Please file the attached document as part of the record in the above captioned proceeding. The document contains answers to questions proposed by staff in advance of MCI's October 3, 1997 meeting.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Kimberly M. Kirby

cc: Melissa Newman (CCB)
Alex Starr (CCB)
Jonathan Askin (CCB)
Jonady Hom (CCB)

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Answers To Staff Proposed Questions

Listed below are answers to questions 1 through 6 posed to MCI in advance of our ex parte meeting October 3, 1997. We have not included a separate discussion of the impact of the 8th Circuit opinion in Iowa Utilities Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), but have instead highlighted within individual answers the few instances in which the 8th Circuit opinion was relevant to the analysis.

I. Barrier to Entry

Before turning to specific questions, we think it is critical to reiterate the relevant determination the Commission must make under § 253(a) -- whether the challenged statute actually prohibits entry, or may have the effect of prohibiting entry. As the Commission recognized in *In the Matter of The Public Utility of Texas*, Memorandum Opinion and Order, FCC 97-346 (rel. Oct. 1, 1997) (Texas Preemption Decision), section 253 is designed to ensure that no state erects "legal barriers to entry that would potentially frustrate the 1996 Act's explicit goal of opening local markets to competition." Id. at ¶ 41. Thus, the Commission is required to preempt "not only express restrictions on entry, but also restrictions that indirectly produce that result." Id.¹

¹ This conclusion is consistent with the commonly accepted meaning of "prohibiting or having the effect of prohibiting" entry. See, e.g., Phillip E. Areeda, et al., Antitrust Law ¶ 420a at 57 (1995), (to have the effect of prohibiting entry, a regulation need not make entry literally impossible because "a barrier may protect a market incumbent without completely excluding entry."; Los Angeles Land Co. v. Brunswick Corp., 6 F.3d 1422, 1428 (9th Cir. 1993), cert.

In determining whether the state statute at issue "would potentially frustrate" the opening of local markets to competition, the Commission's inquiry is necessarily prospective. Thus, in reviewing a statute that may properly be subject to preemption under § 253, the Commission should not ask merely whether the statute has in the past operated to restrict entry, but rather should review the challenged statute to determine whether it may now or in the future have the effect of deterring entry by potential competitors. As set out more fully in MCI's preemption petition, a number of provisions of the Arkansas statute are designed to, and will in fact, discourage competition, frustrating "the 1996 Act's explicit goal of opening local markets to competition," and preventing new entrants from effectively competing in Arkansas local markets. The Commission should therefore declare that they are preempted.

II. ANSWERS TO SPECIFIC QUESTIONS

Question 1: Given that MCI has not alleged that it provides, or has any present intention to provide, local service in Arkansas, does MCI have standing to seek preemption of the Arkansas Act pursuant to either the Supremacy Clause or section 253?

The Commission has ample authority to decide MCI's petition on the merits; the doctrine of standing does not act as a bar. "Standing involves one question: who can obtain

denied, 114 S. Ct. 1307 (1994) ("The disadvantage of new entrants as compared to incumbents is the hallmark of an entry barrier.") "A barrier to entry is any factor that permits firms already in the market to earn returns above the competitive level while deterring outsiders from entering." Areeda, ¶ 420a at 55-56; see Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1439 (9th Cir. 1995), cert. denied, 116 S. Ct. 515 (1995) ("Barriers to entry may be defined as either additional long-run costs that were not incurred by incumbent firms but must be incurred by new entrants or factors in the market that deter entry while permitting incumbent firms to earn monopoly returns.") (internal quotes omitted).

MCI Ex Parte
CC Docket No. 97-100
Answers To Staff Questions 1-6
October 29, 1997

judicial review . . .” III Davis, Administrative Law Treatise § 16.02 (3rd Ed. 1994) (emphasis added). The doctrine of standing derives from constitutional limitations on Article III courts -- specifically the limitation that such courts hear only actual cases or controversies. Thus, “in terms of Article III limitations on federal court jurisdiction, the question of standing is related only to whether the dispute sought to be adjudicated will be presented in an adversary context and in a form historically viewed as capable of judicial resolution.” Flast v. Cohen, 392 U.S. 83, 101 (1968). The requirement that a party demonstrate “injury in fact” arises out of this case or controversy requirement. Id.

The FCC, of course, is not an Article III court and is not constrained by the same constitutional limitations. The Commission has the clear authority to consider and decide issues that are not presented in a purely adversarial context. Indeed, in this matter, the Commission could issue a notice *sua sponte* indicating that the Arkansas Act appears to conflict with federal law and is a barrier to entry, and, after notice and comment, exercise its preemption authority. The doctrine of standing does not, therefore, impact the Commission’s ability to act on MCI’s petition.

Question 2: Does the Arkansas Act preclude the Arkansas Commission from ordering an incumbent LEC to unbundle a network element not specified in the FCC’s Local Competition Order? If not, describe the bases for your contention with particularity and explain the bases for the Arkansas Commission’s decision to order the unbundling of dark fiber in the AT&T/SWBT arbitration?

and

Question 3: Describe with particularity the bases for your contention that section 9(f) of the

MCI Ex Parte
CC Docket No. 97-100
Answers To Staff Questions 1-6
October 29, 1997

Arkansas Act conflicts with federal law.

Sections 9(d) and 9(f) of the Arkansas Act appear to limit the state commission's power to fulfill its duties under the Federal Act. Under §9(d), the state commission is prohibited from requiring an ILEC "to negotiate resale of its retail communications services, to provide interconnection, or to sell unbundled network elements to a competing local exchange carrier for the purpose of allowing such competing local exchange carrier to compete with the [ILEC] in the provision of basic local exchange service" except as required by the Federal Act. Although §251(c)(3) of the Federal Act requires the unbundling of certain elements, see 47 C.F.R. §51.319, this commission has recognized that §251(d)(2)(A) allows the states to require the unbundling of additional elements. See Local Competition Order at ¶283. Thus, as this commission found, the Federal Act serves as a floor, not a ceiling.

Section 9(d) of the Arkansas Act, on the other hand, mandates that the Federal Act serve as a ceiling, by precluding the state commission from ordering an ILEC to unbundle elements beyond those specifically required by the Federal Act, even if further unbundling is consistent with the Federal Act and furthers its goal of promoting competition. Although the state commission may on occasion order further unbundling despite the plain language of §9(d), in MCI's view §9(d) may pose a considerable hurdle to the state commission's ability to do so. If the Arkansas commission recognizes this hurdle in future arbitrations, it will be unable to act to carry out its responsibilities under the Federal Act, and this Commission will have to preempt its jurisdiction over the arbitration, pursuant to §252(e)(5).

Section 9(f) of the Arkansas Act similarly appears to limit the power of the state commission to carry out its responsibilities under the Federal Act. That section limits the commission's authority with respect to interconnection, resale and unbundling to "the terms, conditions and agreements pursuant to which an incumbent local exchange carrier will provide interconnection, resale, or unbundling to a CLEC for the purpose of the CLEC competing with the incumbent local exchange carrier in the provision of telecommunications services to end-user customers." §9(f). By contrast, the Federal Act vests in state commissions the responsibility to perform numerous other functions with respect to interconnection, resale and unbundling.²

For example, under §252(b) of the Federal Act, the state commission has the power to arbitrate any open issue arising out of a request for interconnection, services or access to unbundled elements. Under §9(f), however, the Arkansas commission would be limited to arbitrating only those issues specifically relating to interconnection, resale or unbundling, and could not arbitrate the variety of other issues which may arise in the context of such a request ---

² Under the Federal Act, state commissions are to determine whether the unbundling of requested elements is technically feasible, §251(c)(3); to calculate, consistent with the Federal Act, the cost for such unbundled elements, §252(d); to calculate, consistent with the Federal Act, the wholesale discount at which services will be sold for resale, §251(c)(4); to determine, consistent with the Federal Act, whether a rural telephone company is exempt from certain of the Act's requirements, §251(f)(1)(A); to review and approve or disapprove negotiated agreements, §252(e)(2); to arbitrate, upon the request of a party, any open issue arising out of a request for interconnection, services, or access to unbundled elements --- including any issue necessary to reach a final agreement, §252(b); to review and approve or disapprove such arbitrated agreements, §252(e)(2); and to review and approve or disapprove statements of generally available terms (SGATs) filed by a Bell operating company pursuant to §252(f), §252(f)(2).

issues it has the duty to arbitrate under the Federal Act.³ Section 9(f) thus appears to create a conflict between the scope of the state commission's duties under the Arkansas Act and the scope of its duties under the Federal Act: the state commission simply cannot comply with both federal and state law. See Fidelity Federal Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1982) (noting that state law conflicts with federal law for purposes of preemption analysis when "compliance with both federal and state regulations is a physical impossibility").

If the state commission during the course of arbitrating section 252 agreements does not feel limited by the Arkansas Act and does fulfill the duties imposed by federal law, there will be no need for the FCC to act. If, however, during the course of an arbitration it becomes apparent that the state commission cannot fulfill the duties imposed on it by the Act because the Arkansas statute precludes it from doing so, this Commission will have to assure jurisdiction over the arbitration proceeding pursuant to § 252(e)(5). As it did in the Texas preemption decision, the Commission should announce that it will monitor the application of the Arkansas Act to determine if, in practice, it conflicts with the requirements of the Act.

Question 4: Describe with particularity the bases for your contention that the second sentence of section 9(d) of the Arkansas Act prohibits or effectively prohibits the ability of an entity to provide a telecommunications service. For example, assume that section 9(d) allows an incumbent LEC to apply the wholesale discount to the ordinary retail rate rather than to the special reduced rate when selling to a competitor a retail service offered to the incumbent LEC's end-user customers at a promotional price for longer than 90 days. Does section 9(d) thereby preclude resale as a viable means of entering the local exchange market? If so, describe how with particularity.

³ See Local Competition Order at ¶ 134 (recognizing that a state commission may be asked to arbitrate an entire interconnection agreement).

MCI Ex Parte
CC Docket No. 97-100
Answers To Staff Questions 1-6
October 29, 1997

Answer:

Section 9(d) of the Arkansas Act flatly denies competing carriers the ability to obtain any “[p]romotional prices, service packages, trial offerings or temporary discounts” for resale. This general exemption effectively forecloses resale as a viable method of entering the local exchange market, because it allows an ILEC to undercut rates offered by resellers simply by sharply raising its “retail” rates, and offering its own end-user customers significantly lower “promotional prices” or “temporary discounts.” For example, an incumbent LEC could set the “retail” rate for a given service at \$10. If the wholesale discount rate is 20%, competitors would be able to purchase the service for \$8. The ILEC could then offer that service to its end-user customers at a “promotional” price of \$6. In order to compete with the ILEC’s \$6 price, a competing carrier would have to resell the service at a price considerably below cost. Because this is obviously not a viable means of doing business, the competing carrier will be precluded from entering the local exchange market through resale.

This Commission explicitly recognized this anti-competitive problem, and for that reason found that the Act does not allow incumbent LECs to exclude from the wholesale rate obligation services offered at promotional and temporary discount prices for periods longer than 90 days. To do so, the Commission found, would be to “unreasonably hamper the efforts of new competitors that seek to enter local markets through resale.” Local Competition Order at ¶ 950.

Section 9(d) of the Arkansas Act codifies the anti-competitive practice that the Commission has already determined the Federal Act will not allow. Because §9(d) of the

MCI Ex Parte
CC Docket No. 97-100
Answers To Staff Questions 1-6
October 29, 1997

Arkansas Act allows an ILEC to sell services to competing carriers at a rate higher than the “promotional” rate at which it sells to its own customers, it effectively prohibits the ability of a competing carrier to resell at a competitive rate any service deemed by the ILEC to be “promotional,” regardless of the length of the “promotion.” Moreover, §9(d) creates an incentive for ILECs continually to offer their services to end-user customers at a “promotional” price so as “to avoid the statutory resale obligation” imposed by the 1996 Act. Local Competition Order at ¶948. Thus, section 9(d) of the Arkansas Act plainly erects a significant barrier to entry into the local exchange market and must be preempted under §253(d) of the 1996 Act.

Question #5: Describe with particularity the bases for your contention that the second and third sentences of section 9(g) of the Arkansas Act prohibit the ability of an entity to provide a telecommunications service. For example, has section 9(g) resulted in a wholesale discount rate lower than the rate that would have resulted from the application of the standards established in the FCC’s *Local Competition Order*? If so, describe with particularity how the differential has created a barrier to entry.

Answer:

Section 252(d)(3) of the federal Act provides that wholesale rates for services sold to competing carriers for resale shall be calculated “on the basis of retail rates charged to subscribers . . . excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.” In contrast, under §9(g) of the Arkansas Act, the wholesale rate is calculated by subtracting from the ILEC’s retail rate “any net avoided costs due to the resale.” Net avoided costs are defined as “the total of the costs that will not be incurred by the local exchange carrier due to it selling the service for resale less any

additional costs that will be incurred as a result of selling the service for the purpose of resale.”

Id. (emphasis added).

Although MCI has been unable to obtain the results from any arbitration already conducted in Arkansas, it is clear that the §9(d) standard, because it directs the ILEC to subtract from the wholesale discount “any additional costs” incurred on resale, will necessarily result in a lower wholesale discount and a correspondingly higher wholesale rate to potential resellers than would result from the standard mandated by the federal Act and the Local Competition Order, which allow for consideration of only those costs avoided by the ILEC and not any costs it incurs.

In establishing resale as one method new competitors can use to enter local markets, Congress carefully crafted the method by which the price of the services must be calculated. The Arkansas Act disrupts this scheme. It directly conflicts with the method set out in the 1996 Act, makes resale more expensive to competitors, and correspondingly makes entry via resale significantly less likely. Because this section of the Arkansas Act deters competitive entry in violation of the Act, it should be preempted.

Question #6: Describe with particularity the bases for your contention that section 10 of the Arkansas Act prohibits the ability of an entity to provide a telecommunications service. For example, describe with particularity the extent to which you believe that the factors listed in section 10(c) of the Arkansas Act exceed merely an elucidation of what constitutes “unduly economically burdensome”, “technically feasible” and “consistent with section 254” within the meaning of section 251(f)(1)(A) of the Communications Act.

Answer:

Section 251(f)(1)(A) of the Federal Act prescribes certain narrow conditions under which a rural telephone company is exempt from the general duties with respect to interconnection, access, and resale imposed on ILECs in §251 of the Act. Section 10 of the Arkansas Act prohibits the ability of an entity to provide a telecommunications service by expanding the instances in which a rural telephone company is exempt from the requirements of §251. As this Commission found, “Congress intended exemption . . . [from] the section 251 requirements to be the exception rather than the rule,” so as not to restrict competition. Local Competition Order at ¶1262. The standards set forth in §10 of the Arkansas Act flaunt the pro-competitive purpose of the Federal Act by expanding the narrow exception contemplated by Congress.⁴

First, §10 of the Arkansas Act effectively insulates rural telephone companies from competition by placing upon the carrier seeking to inject competition into the local market the burden of showing that the rural company’s exemption should be terminated. Specifically, §10(b) places the burden on requesting carriers to prove by “clear and convincing evidence” that the request for interconnection, services or network elements (1) is not unduly economically burdensome; (2) is technically feasible; and (3) is consistent with the protection of universal service and the public interest, convenience and necessity. The Arkansas Act thus expressly

⁴ In Iowa Utilities Bd v. FCC, 120 F.3d 753, 801-03 (8th Cir. 1997), the Eighth Circuit invalidated 47 C.F.R. §51.405, which contained this Commission’s standards for implementing §251(f), on the grounds that this Commission lacked authority to promulgate the rule. The Eighth Circuit’s invalidation of this regulation on jurisdictional grounds, however, is irrelevant to a determination of whether the standards found in the Arkansas Act conflict with the federal Act itself, or whether the existence of those standards creates a barrier to entry into the local market.

protects the monopoly status of rural telephone companies unless their would-be competitors -- who have no access to financial and other data contained in the incumbents' files -- can prove that no harm would result from subjecting the rural telephone company to competition. This stands the goal of the 1996 Act on its head, and will necessarily curtail, or prevent altogether, the development of competition. Moreover, the burden placed upon requesting carriers is not merely to convince the state commission by a preponderance of the evidence that an exemption is not warranted, but to do so by clear and convincing evidence --- an extraordinary standard not contemplated by the Federal Act. Carriers who would otherwise attempt to compete with rural telephone companies will certainly choose not to do so when confronted with a regulatory regime that requires them to prove a negative (that no harm will result from competition) by clear and convincing evidence that they do not have in their possession.

Second, §10 of the Arkansas Act mandates that factors beyond those enumerated in the federal Act must be satisfied before the state commission may find that an exemption is not warranted. Congress has made the determination that competition is in the public interest, and granted rural telephone companies a limited exemption from competition, but only if specific factors are met. Section 10 seeks to graft an additional section onto the Federal Act, requiring the commission to continue an exemption unless it finds that there will be no significant adverse impact in ten specific areas.⁵ No matter how laudable the Act's additional requirements may

⁵The commission must conclude that there will be no significant adverse impact on "(1) The customers of the incumbent local exchange carrier serving the area; (2) The incumbent local exchange carrier's ability to continue to meet eligible carrier obligations; (3) The incumbent local

appear, they clearly make it more difficult for competitors to enter a rural market and thus flatly conflict with the requirements of the 1996 Act.

These additional factors go beyond merely an "elucidation" of the only three factors enumerated in the Federal Act. Indeed, §10(c) vests in the state commission seemingly unlimited discretion to consider not only ten enumerated factors beyond those specified in the Federal Act, but also any "other relevant matters." By granting it such broad discretion, §10(c) virtually eliminates the constraints placed on state commissions by the Federal Act. The effect of this will be to insulate rural telephone companies from their obligations under the Federal Act and to prevent competing carriers from entering the local market. In these ways, §10 of the Arkansas Act ensures that instead of serving as the exception contemplated by Congress, the rural telephone company exemption will become the rule in Arkansas.

exchange carrier's ability to continue to meet eligible carrier obligations; (4) Statewide average toll rates; (5) Customers cost of telephone service; (6) The goals of universal service; (7) The quality of service provided to customers; (8) The incumbent local exchange carrier's ability to attract capital and incur debt at reasonable rates and the ability to sustain sufficient revenue stream to pay existing debt; (9) The ability of the exchange to support more than one local exchange carrier; and (10) The interest of all ratepayers." §10(c).